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**FIRST NATIONAL STORES INC.
ANNUAL REPORT**

FOR THE YEAR ENDED MARCH 30

1968

FIRST NATIONAL STORES INC.

OFFICERS

ADRIAN O'KEEFFE, *Chairman of the Board*
HILLIARD J. COAN, *President*
ALAN L. HABERMAN, *Executive Vice President*
JOHN W. MACNEIL, *Vice President*
RICHARD M. O'KEEFFE, *Vice President*
WILLIAM R. POWERS, II, *Vice President*
PETER C. QUINN, *Vice President*
WILLIAM A. RYAN, *Vice President, Secretary and Clerk*
WILLIAM A. FERRARA, *Treasurer*
ROBERT B. McCANN, *Controller*

DIRECTORS

HILLIARD J. COAN
RICHARD C. EVARTS
JOHN F. LEBOR
JOHN L. MACNEIL
EDWARD W. MILLER
ADRIAN O'KEEFFE
BERNARD M. O'KEEFFE
WILLIAM A. RYAN

EXECUTIVE COMMITTEE

HILLIARD J. COAN
ADRIAN O'KEEFFE
WILLIAM A. RYAN

TO OUR SHAREHOLDERS:

Somerville, Massachusetts, May 31, 1968

Sales in the 53-week fiscal year ended March 30, 1968, were \$640,116,000 compared with \$641,896,000 in the 52 weeks of the prior year. A loss of \$6,644,000 or \$.414 per share was incurred during the year. In the preceding year there was a loss before extraordinary items of \$976,000 or 60¢ per share.

During the year the Company's operations were adversely affected by three serious labor disputes. The most recent of these occurred in our third quarter and resulted in the closing of two hundred ninety-eight of our stores for a period of twenty-one days. The other two disputes caused the closing of thirty-eight of our stores for a period of ten days and the suspension of operations in our largest distribution and manufacturing center for a week. These strikes had a substantial impact on sales and earnings, interrupted a favorable sales trend and made necessary costly measures to regain our customers. However, March quarter sales on a weekly basis were five percent ahead of those of the preceding year.

Dividends amounted to fifty cents per share, consisting of two quarterly payments in July and October. No dividends have been paid since. In the prior year a total of \$1.50 was paid.

Summary:	<i>For the Year Ended</i>	
	<i>March 30, 1968</i>	<i>March 25, 1967</i>
Retail store sales	\$640,116,000	\$641,896,000
Net loss before extraordinary items	6,644,000	976,000
Extraordinary items, net	—	(280,000)
Net loss	6,644,000	696,000
Per share of common stock —		
Loss before extraordinary items	4.14	.60
Extraordinary items	—	(.17)
Net loss	4.14	.43
Net working capital	34,910,000	40,513,000
Fixed assets, less depreciation	53,591,000	57,833,000
Stockholders' equity	84,707,000	92,246,000

Working capital at March 30, 1968 was \$34,910,000 as against \$40,513,000 at the close of last year. Current assets amounted to \$66,611,000 and current liabilities were \$31,701,000 or a ratio of 2.10 to 1 compared with a 2.26 ratio a year earlier. Net capital expenditures for the year totaled \$5,140,000. Long-term debt was \$3,995,000, a reduction of \$534,000.

Approximately eighteen months ago new management was brought into the Company and assigned the task of evaluating operational practices, merchandising concepts and organizational structure with the purpose of making the necessary changes to revitalize our business. Some of the changes that were made have had adverse effects upon current earnings but they assure the future success of the Company.

Structural changes have occurred in buying, merchandising, store operations, field supervision, divisional management, advertising, warehousing, transportation and manufacturing.

Operational changes have resulted in consolidation of warehousing and transportation. At the present time all warehousing and distribution is centered in three locations — Somerville, Massachusetts, East Hartford, Connecticut and Kearny, New Jersey. Other changes included the elimination of certain of our own manufactured products, consolidation of bakery facilities and the introduction of operational standards at store level designed to improve customer service.

Our methods and techniques in every area of the Company are under continuing review. We have made major revisions in our internal reporting system to provide more complete information for control and decision making. Most store managers are no longer members of the union, and have been given complete control and direction of all departments in their stores. Our merchandising teams have attacked with vigor the assignment of adapting individual stores to the wants and needs of each of the many distinct neighborhoods we serve. This includes responding where necessary to destructive price competition, the introduction and presentation of many ethnic and specialized lines of merchandise and the promotional and institutional advertising necessary to improve individual store sales and our neighborhood image.

We have been successful in maintaining approximately the same sales volume during this period in spite of labor stoppages and the closing out of obsolete stores.

In the course of the year forty-seven stores were closed, eleven new stores were opened and fourteen stores had major remodelings or expansion of their facilities. At the year end there were four hundred eighty-one stores in operation as compared with five hundred seventeen stores at the same time last year. Average sales per store on a comparative basis increased during the year. In the fourth quarter the average increase was 13.8% over the prior year, reflecting both the implementation of our program of eliminating smaller units and sales gains in many stores. In identical supermarkets there was an average increase of 6.8%.

There are fourteen new stores planned for opening in the current year and approximately thirty remodelings and enlargements scheduled. These remodels and enlargements are mainly in areas which have excellent potential and it is expected that this investment will produce a satisfactory return.

The new organizational concept that we began to implement in 1967 is now in effect in all but a few of our stores, in our supervisory staffs and in all divisions. It is being reinforced by management seminars and training programs to assure the earliest possible attainment of our operating and merchandising goals. This constructive approach to modern supermarket management is resulting in more efficient, more attractive stores and better service to our customers.

Beginning in the second quarter of the current fiscal year, an incentive plan for store managers and store supervisory people will be started. Under this program the compensation of this most important segment of management will be related to their performance in their specific areas of responsibility. The incentive plan, which is tied to certain performance objectives of the training programs, is most important to the future progress of our Company.

In an announcement on May 10, 1968 by our Company and King Kullen Grocery Co., Inc., it was stated that preliminary discussions were being held involving an offer by our Company to acquire all of the stock of King Kullen which operates fifty stores on Long Island for approximately \$12,000,000. Detailed studies are now being conducted to determine the practicality of the acquisition before approval of our Board is requested.

Many of the changes during the past year and a half, while costly in their inception, will result in future economies. We believe that all of them together have laid the groundwork for progress in the future. In certain areas, sales, share of market and number of customers showed a marked improvement. There are still many areas which require concentrated effort toward the early accomplishment of our goals, paramount among which is a return to profitable operations.

We express our appreciation to our customers, employees and stockholders for their support during the year.

ADRIAN O'KEEFFE
Chairman of the Board

Respectfully submitted,

HILLIARD J. COAN
President

FIRST NATIONAL

SUPER FINAST SHOP-COMPARE



In stores and offices alike, constant attention is directed toward customer needs and services. Company seminars and training programs alert management and supervisory personnel to current operating procedures. Advertising and promotional programs, developed through the exchange of ideas, are designed to attract customers, both present and future.



FIRST NATION
CONSOLIDATED

ASSETS

	MARCH 30 1968	MARCH 25 1967
Current assets:		
Cash	\$ 8,741,000	\$ 14,117,000
Short term investments, at cost (approximate market)	2,484,000	7,462,000
Accounts receivable, less allowance for doubtful accounts	4,274,000	3,512,000
Refundable federal income taxes	4,904,000	3,500,000
Inventories, at cost (substantially on the basis of last-in, first-out) or market whichever is lower	41,537,000	38,648,000
Prepaid expenses and other current assets	4,671,000	5,318,000
Total current assets	66,611,000	72,557,000
Fixed assets, at cost (excluding fully-depreciated assets):		
Land	8,174,000	8,149,000
Buildings owned	32,635,000	35,072,000
Store fixtures, leasehold improvements, machinery and equipment	83,955,000	82,721,000
Automotive equipment	7,389,000	7,417,000
	132,153,000	133,359,000
Less — Depreciation	78,562,000	75,526,000
	53,591,000	57,833,000
Other assets and deferred charges	2,966,000	1,627,000
	\$123,168,000	\$132,017,000

AL STORES INC.

BALANCE SHEET

LIABILITIES

	MARCH 30 1968	MARCH 25 1967
Current liabilities:		
Accounts payable	\$ 21,930,000	\$ 22,915,000
Accrued expenses	9,504,000	8,083,000
Current portion of long-term debt	267,000	267,000
Federal income taxes	—	779,000
Total current liabilities	31,701,000	32,044,000
4.70% Notes, due in equal semiannual instalments to 1976	3,995,000	4,529,000
Reserve for estimated losses on closed stores (Note 5)	2,665,000	3,098,000
Deferred income taxes	100,000	100,000
Stockholders' equity:		
Common stock, without par value (Note 2):		
Authorized — 2,000,000 shares		
Issued — 1,655,268 shares	31,977,000	31,977,000
Retained earnings (Note 2)	54,547,000	61,993,000
	86,524,000	93,970,000
Less — Treasury stock, at cost, 50,064 shares in 1968; 46,664 shares in 1967	1,817,000	1,724,000
	84,707,000	92,246,000
Lease commitments (Note 3)	\$123,168,000	\$132,017,000

FIRST NATIONAL STORES INC.

CONSOLIDATED STATEMENT OF LOSS AND RETAINED EARNINGS

	YEAR ENDED	
	MARCH 30, 1968 (53 weeks)	MARCH 25, 1967 (52 weeks)
Income:		
Sales	\$640,116,000	\$641,896,000
Gain on disposal of fixed assets — net	196,000	31,000
Other income	498,000	553,000
	<u>640,810,000</u>	<u>642,480,000</u>
Costs and expenses:		
Cost of sales, warehousing, transportation and store occupancy expenses	545,296,000	534,150,000
Direct selling (exclusive of store occupancy expenses)		
publicity, general and administrative expenses	98,795,000	102,265,000
Provision for depreciation	8,114,000	8,960,000
Interest expense	379,000	296,000
Refund of federal income taxes (Note 1)	(5,130,000)	(2,215,000)
	<u>647,454,000</u>	<u>643,456,000</u>
Loss before extraordinary items	6,644,000	976,000
Extraordinary items:		
Provision for loss on disposition of closed stores, net of \$3,800,000 estimated income tax benefits	—	4,000,000
Portion of reserve for obsolescence no longer required (not deducted for income tax purposes during years in which provided)	—	(4,280,000)
	<u>—</u>	<u>(280,000)</u>
Net loss	6,644,000	696,000
Retained earnings at beginning of year	61,993,000	65,126,000
Cash dividends paid — \$.50 per share in 1968; \$1.50 per share in 1967	802,000	2,437,000
Retained earnings at end of year	<u>\$ 54,547,000</u>	<u>\$ 61,993,000</u>
Per share of common stock —		
Loss before extraordinary items	\$4.14	\$.60
Extraordinary items, net of tax	—	(.17)
Net loss	<u>\$4.14</u>	<u>\$.43</u>

CONSOLIDATED STATEMENT OF SOURCE AND USE OF FUNDS YEAR ENDED MARCH 30, 1968

Source of funds:		
Net loss	\$(6,644,000)	
Depreciation of fixed assets	8,114,000	
	<u>1,470,000</u>	
Use of funds:		
Net additions to fixed assets	5,140,000	
Cash dividends paid	802,000	
Reduction in long-term debt	534,000	
Acquisitions of treasury stock	93,000	
Net charges to reserve for estimated losses on closed stores (Note 5)	433,000	
Other, net	71,000	
	<u>7,073,000</u>	
Reduction in working capital	<u>\$ 5,603,000</u>	

FIRST NATIONAL STORES INC. NOTES TO FINANCIAL STATEMENTS

NOTE 1 — FEDERAL INCOME TAXES

At March 30, 1968, the Company had available as a credit against future taxable income through 1973 a net operating loss carryforward of approximately \$3,200,000, of which approximately \$560,000 related to accelerated methods of depreciation used for tax purposes only. In addition, an investment credit carryforward of approximately \$300,000 is available.

NOTE 2 — COMMON STOCK AND RETAINED EARNINGS

As of March 25, 1967 options to purchase 39,100 shares of the Company's common stock were held by certain officers and key employees of the Company and its subsidiaries. During the year options for 11,300 shares terminated. At March 30, 1968 options for 27,800 shares were outstanding at prices ranging from \$27.125 to \$64.25 per share, of which options for 22,175 shares were then exercisable. The options become exercisable in equal annual instalments over a four-year period beginning one year after the date granted. Under the terms of the plan, as amended, additional options for 47,200 shares may be granted at prices no less than the fair market value of the common stock at the date of grant and such options expire not more than five years after the date granted.

At March 30, 1968 the portion of retained earnings available for the payment of cash dividends and acquisition of the Company's common stock was approximately \$7,950,000 as calculated in accordance with the terms of the loan agreement covering the long-term debt.

NOTE 3 — LEASE COMMITMENTS

At March 30, 1968 the Company was committed under 439 leases covering stores and other properties. The minimum annual rentals under these leases amount to approximately \$10,900,000 exclusive of real estate taxes and other expenses or additional rentals based on percentage of sales. Of the minimum annual rental commitment, approximately 53% related to leases expiring within 10 years and approximately 92% to leases expiring within 15 years. Leases on certain closed stores have not been included in the above totals (see Note 5).

NOTE 4 — PENSIONS

The Company maintains a trustee noncontributory pension plan. It has been determined that no contribution to the Company plan will be required for several years as a result of the amortization of actuarial gains resulting from a change in the interest assumption and transfer of employees to various union pension plans plus a portion of the unrealized appreciation in the current fund. Total pension costs charged to earnings representing contributions to union plans was \$1,507,000 in 1968 and \$667,000 in 1967.

NOTE 5 — RESERVE FOR ESTIMATED LOSSES ON CLOSED STORES

The program of closing certain stores which lacked potential for future profitability has been substantially completed. A reserve has been provided for the estimated losses on lease terminations and write-downs of fixtures in stores closed or to be closed by an extraordinary charge to earnings for the year ended March 25, 1967. The costs incurred in 1967 and 1968 less the related tax effects have been charged to this reserve and the balance at March 30, 1968 is considered adequate for the estimated future costs to be incurred.

NOTE 6 — SUBSEQUENT EVENT

Reference is made to the President's letter to the shareholders for comment on negotiations relative to the possible acquisition of King Kullen Grocery Co., Inc.

REPORT OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF FIRST NATIONAL STORES INC.

In our opinion, the accompanying consolidated balance sheet, the statement of loss and retained earnings and the statement of source and use of funds present fairly the financial position of First National Stores Inc. and its subsidiaries at March 30, 1968 and the results of their operations and the supplementary information on funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of these statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Boston, Massachusetts
May 24, 1968

PRICE WATERHOUSE & CO.

FIRST NATIONAL STORES INC.

TEN-YEAR REVIEW (IN THOUSANDS OF DOLLARS EXCEPT FOR PER SHARE AMOUNTS)

	1968 ¹	1967 ¹	1966 ¹	1965	1964	1963	1962	1961	1960	1959
RESULTS OF OPERATIONS										
Retail store sales	\$ 640,116	\$ 641,896	\$ 684,898	\$ 706,670	\$ 723,402	\$ 746,089	\$ 711,304	\$ 536,486	\$ 525,351	\$ 531,521
Net earnings (loss) ²	(6,644)	(976)	2,404	5,560	7,103	7,788	8,172	7,859	8,223	8,649
Net earnings (loss) per share ²	(4.14)	(.60)	1.47	3.39	4.33	4.73	4.98	4.80	5.02	5.28
Cash dividends per share	.50	1.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
FINANCIAL POSITION										
Current assets	66,611	72,557	65,773	59,985	61,502	65,466	68,802	52,100	44,737	43,665
Current liabilities	31,701	32,044	23,666	25,020	31,604	36,663	46,017	29,997	24,226	25,258
Net working capital	34,910	40,513	42,107	34,965	29,898	28,803	22,785	22,103	20,511	18,407
Ratio of current assets to current liabilities	2.10	2.26	2.78	2.40	1.95	1.79	1.50	1.74	1.85	1.73
Fixed assets, net	53,591	57,833	59,017	62,916	66,259	66,312	68,138	58,061	57,172	55,411
Total assets	123,168	132,017	125,824	129,592	134,907	138,994	145,596	115,040	105,503	102,405
Long term debt	3,995	4,529	6,131	6,665	7,733	9,750	10,250	—	—	—
Stockholders' equity	84,707	92,246	96,027	97,907	95,570	92,581	89,329	85,043	81,277	77,147
OTHER DATA										
Capital expenditures — net	5,140	4,626	6,311	7,669	11,341	9,967	20,982	9,767	11,239	11,636
Provision for depreciation	8,114	8,960	10,468	11,367	11,606	12,354	10,533	9,517	9,411	8,912
Shares of common stock outstanding (at end of year)	1,605,204	1,608,604	1,631,404	1,638,904	1,639,204	1,639,598	1,647,670	1,637,154	1,637,154	1,637,154
Number of stores (at end of year)	481	517	573	600	601	610	632	516	534	543

¹Consolidated; parent company only shown for prior years.

²Before extraordinary items.

Geographical Distribution
of
481 FIRST NATIONAL STORES



TRANSFER AGENTS: THE FIRST NATIONAL BANK OF BOSTON, BOSTON, MASS.
CHEMICAL BANK NEW YORK TRUST COMPANY, NEW YORK, N.Y.

REGISTRARS: STATE STREET BANK AND TRUST CO., BOSTON, MASS.
BANKERS TRUST CO., NEW YORK, N.Y.

